Internal Revenue Service
# memorandum

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Br2:PLBurquest-Fultz

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to: District Counsel, Indianapolis CC:IND
Attention: Elsie Hall

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: **Relocation Expenses - Capital v. Ordinary Deduction Reconciliation of Rev. Rul. 82-204 and PLR 8425069**
(Nondocketed)

This is in response to your request for advice dated October 17, 1988, on the characterization of expenses incurred by a [redacted] pursuant to its employee relocation program which involves an independent relocating company.

ISSUE

Whether various expenses incurred by an employer pursuant to an employee relocation program which assists the relocation of employees via the purchase of their personal residences, are capital.

CONCLUSION

The homes purchased by [redacted] through its agent, [redacted], are capital assets to [redacted]. Accordingly, expenditures to acquire and sell these properties are capital costs that are either added to the basis of the property or reduce the amount realized for purposes of determining gain or loss on the sale of the property to the ultimate purchaser. These costs include brokers' commissions, mortgage payments, fix-up expenses, and closing costs. Maintenance costs and other operating expenses are currently deductible.

FACTS

The facts on which the discussion and conclusions in this memorandum are based were provided by Joseph Hoggard, Team Coordinator (Examination). Those facts are summarized below.

On [redacted], [redacted] entered into a Master Agreement with [redacted]. (hereinafter referred to as [redacted]) whereby [redacted] agreed to buy the homes of designated relocated [redacted] employees. The Master Agreement includes the following conditions:

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(1) [redacted] is authorized to establish the value of the employee's home via the average amount of two independent appraisals performed at [redacted]'s expense;

(2) Within 30 days from the date of [redacted]'s offer letter to the employee, the employee submits to [redacted] the completed Notice of Acceptance, Contract of Sale and other required documents;

(3) Upon receipt of these documents, [redacted] will pay to the employee his/her equity in the home as defined in the Contract of Sale;

(4) [redacted] will request, by telephone, an advance from [redacted] for the amount of the employee's equity. [redacted] will arrange for wire transfer of the funds to [redacted]'s bank account on the next legal banking day;

(5) All responsibilities of ownership such as taxes, insurance and mortgage payments will be assumed by [redacted] while the home is in its inventory;

(6) [redacted] will reimburse [redacted] for all direct expenses related to the homes while in [redacted]'s inventory (including taxes, insurance, etc.). This is accomplished through a fixed monthly charge which is adjusted to actual at the end of the quarter in which the home is sold;

(7) [redacted] will pay [redacted] percent of the home's established value to cover [redacted]'s office and overhead expenses;

(8) [redacted] will pay [redacted] a fixed profit of [redacted] percent of the home's established value; and

(9) [redacted] will list the homes for sale. [redacted] is free to accept any offer unless the offer is less than [redacted] percent of the established value. In such case, [redacted] shall consult with [redacted] before accepting the offer.

In addition to the above conditions, [redacted] will reimburse [redacted] for all closing costs, brokerage commissions, fix-up expenses, seller's discount, recording fees, abstracts, title insurance and other costs. [redacted] will reimburse [redacted] for any loss sustained when the ultimate sales price is less than the appraised value of the home at the time [redacted] purchases the home from the employee via [redacted].

For tax years [redacted] and [redacted], Exam has proposed to make adjustments to [redacted]'s reported relocation plan activity. These adjustments will recharacterize various expenses as capital expenditures, and will recharacterize losses sustained on the subsequent sale of the houses as capital losses rather than an ordinary and necessary business expenses under I.R.C. § 162(a).

Based on the information received with your request, we believe there is a strong probability that [redacted] would likely be considered [redacted]'s agent for tax purposes. However, all aspects of the relationship between [redacted] and [redacted] should be considered to determine if, under Nebraska law, such agency relationship exists. We have assumed that such a relationship does exist in arriving at our conclusions in this memorandum.

You have requested our views on the application of Rev. Rul. 82-204, 1982-2 C.B. 192, to characterize the costs associated with the homes as capital. The Team Coordinator has raised the potential inconsistency between the treatment of the homes as capital assets under the revenue ruling and a private letter ruling (PLR 8425069) which treats the employer's relocation plan expenses as ordinary and necessary business expenses under section 162(a).

DISCUSSION

In Rev. Rul. 82-204, 1982-2 C.B. 192, the Service ruled that the personal residences of employees purchased by an employer pursuant to an employee relocation (home buying) program were capital assets within the meaning of section 1221. Prior to the issuance of the ruling, however, the Chief Counsel's Office concluded in [redacted], GCM 36361, I-570-74 (Aug. 6, 1975), that the sales of houses in the home buying program described in the ruling should result in ordinary gains and losses, relying on the so-called "Corn Products doctrine." GCM 36361 was revoked by [redacted], GCM 38607, I-570-74 (Jan. 7, 1981) which concluded that Corn Products should not be used to support the ordinary characterization of gains and losses incurred in the employee relocation program described in (proposed) Rev. Rul. 82-204; furthermore, the homes are properly characterized as capital assets within the meaning of section 1221. Rev. Rul. 82-204 was then finalized and issued consistent with the position announced in GCM 38607.

During the drafting of Rev. Rul. 82-204 the Service considered an additional issue, namely, whether selling expenses incurred by the employer under the relocation (home buying) program were deductible under section 162. It was preliminarily concluded that the expenses were not deductible under section 162, but instead, were acquisition and disposition costs. Accordingly, acquisition costs, such as purchase commissions, would be capitalized and added to the basis of the homes, consistent with Commissioner v. Winmill, 305 U.S. 79 (1938). Selling costs, such as selling commissions would be treated as reducing the "amount realized" in calculating gain or loss from the disposition of the homes, consistent with Spreckels v. Commissioner. 315 U.S. 626 (1942). When the ruling was finally issued, the second issue was omitted.

The Team Coordinator has stated that the conclusion reached by Rev. Rul. 82-204 appears to be inconsistent with PLR 8435069, which treats the employer's expenses under the relocation program as current deductions under section 162(a). From our review of the files underlying the issuance of PLR 8425069 we have found no indication of intent to distinguish Rev. Rul. 82-204. However, we do note that the letter ruling is consistent with several other letter rulings under substantially similar facts.[1] We also note that the relocation program described in the facts of this case is substantially similar to the facts of the private letter rulings. The apparent inconsistency of treatment between the private letter rulings and Rev. Rul. 82-204 is based on the existence of a relocation company, unrelated to the employer. For example, in PLR 8430085, an employer established a relocation program in which the employer purchased relocated employees' homes and incurred expenses for appraisal fees, real estate commissions, carrying costs, any loss on the sale of the residence, and state and local realty transfer taxes. The ruling concludes that utility costs, maintenance expenses, fire insurance premiums, and similar expenses are properly deductible under section 162(a) by the employer. Furthermore, property tax expenses are deductible by the employer under sections 164(a). However, mortgage payments were considered nondeductible as capital expenditures under section 263 (i.e., acquisition costs), and sales commissions were treated as an offset to the selling price of the residence.

We are unable to reconcile the current deductibility of employer expenses where a relocation company functioning as an agent of the employer is involved (as in PLR 8425069) with the characterization of the homes as capital assets to the employer where no relocation company is involved. As discussed in the

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[1] For example, the ruling is consistent with the holdings of PLR 8428031, PLR 8406033,, PLR 8244032 and PLR 8221120. These rulings hold that payments made by an employer to an unrelated relocation company as a part of the employer's employee relocation program are ordinary and necessary business expenses under section 162(a). The payments include: closing costs, carrying expenses (property taxes, insurance, utilities, etc.), the loss incurred by the relocation company on sale of the house below the appraised value (the relocation company's cost of the property), allocated indirect costs, plus other costs stated as a percentage of value of the house (i.e., the relocation company's profit). There is no mention of real estate commissions in any of the rulings.

following paragraphs, where the relocation company is considered the agent of the employer, the characterization of the expenses should be the same as if the employer directly obtained the property from the relocated employee. That characterization should be capital. Accordingly, we do not believe PLR 8425069 accurately reflects current Service position where the relocation company is considered to be the agent of the employer.

In Reconsideration of Rev. Rul. 72-339, GCM 37888, I-43-78 (Mar. 20, 1979), the Chief Counsel's Office concluded that the use of an unrelated relocation company in the employee relocation program operates essentially the same way as if the employer had purchased the employee's residence. In other words, if an employer hires an agent to purchase an employee's home on behalf of the employer, the situation is substantially the same as if the employer had purchased the employee's home directly. The rationale for this conclusion is that the employer has assumed the benefits and burdens of ownership of the home, including the risk that the property will "ultimately sell for less than the amount the employer, or its agent, paid to the employee." GCM 37888, at p. 5. Viewed as a sale to the employer, we believe that the characterization of the homes as capital assets in Rev. Rul. 82-204 requires that acquisition and disposition costs incurred should be properly characterized as capital expenditures.

We further believe that PLR 8425069 is inconsistent with Service position after the Supreme Court's opinion in Arkansas Best, 108 S. Ct. 971 (1988). Specifically, the homes purchased would properly be characterized as capital assets under section 1221. This result is consistent with Rev. Rul. 82-204, supra, GCM 38607, supra, and [redacted], OM 20064, I-220-86 (Feb. 18, 1987). In OM 20064, the Service called for a strict reading of the definition of the term "capital asset" under section 1221 and a repudiation of the "Corn Products doctrine." Accordingly, acquisition costs (such as mortgage payments) and selling costs (such as closing costs, real estate commissions, fixing up expenses) should be treated as capital costs rather than ordinary and necessary business expenses under section 162. The acquisition costs will increase basis under section 1012 and the selling costs will decrease the amount realized on the employer's sale to the ultimate purchaser under section 1001.

Based on the above discussion, which has been informally coordinated with the Office of Associate Chief Counsel (Technical), we believe that PLR 8425069 should not be followed in determining the tax consequences to the [redacted] in the plan described above if [redacted] is considered to be [redacted]'s agent under Nebraska law. Under these circumstances, [redacted] would be treated as the actual owner of the homes and those homes would be capital assets in its hands. Accordingly, all costs must be separately analyzed to determine tax characterization. Specifically, capital costs include: mortgage payments, brokers' commissions (deducted from the amount realized on sale), selling costs (closing costs, recording fees, etc.), fixing-up expenses, and the loss on the ultimate sale by the employer or his/her agent to the ultimate purchaser. Operating expenses such as insurance, maintenance costs, property management fees, and similar costs are properly characterized as ordinary and necessary business expenses under section 162(a). Finally, real estate taxes and other transfer taxes are currently deductible under section 164.

## CONCLUSION AND RECOMMENDATION

We have concluded that where [redacted] is [redacted]s agent in the relocation program, the houses are properly characterized [redacted] capital assets to [redacted] under Rev. Rul. 82-204 and [redacted]. Any sale thereof results in capital gain or loss. We have further concluded that PLR 8425069 does not accurately reflect current Service position regarding employee relocation programs, such as that used by [redacted], where the employer would be considered to be the owner of the homes. We recommend that the nature of all costs be examined to determine whether they are capital costs or currently deductible expenses. Adjustments should be proposed to characterize brokers' commissions, fix-up expenses, closing costs, and loss on the sale of the homes as capital in nature.

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